

Answer to  
EREG public consultation paper on Pilot Framework  
Guideline on Gas Balancing Rules  
(E10-GNM-13-03b)

Gas Committee  
European Federation of Energy Traders  
October 2010

## Introduction

The Madrid Gas Forum and the EU Gas Regulation favour the implementation of market-based balancing. Full implementation of market-based balancing is consistent with establishing a traded market that can be accessed both by the transmission system users and the TSOs within the balancing period. This note recognises that a special effort is now needed by TSOs, Regulators and Market Participants to achieve this. EFET currently is engaged in discussions with all stakeholders on how best to tackle the challenges that a uniform target model for a European gas balancing regime might impose on some markets. Where there are specific concerns for a particular market around levels of market maturity, transitional measures can be implemented to provide safeguards while market players become more practised in their new roles. There is a realistic chance to achieve consensus on such a target model and respective interim steps and EFET would like to encourage ERGEG to seize this chance within the current consultation.

Our objective in this paper is to set out some practical considerations to help ensure that a full transition to market-based balancing is achieved across Europe.

Core elements of this paper are:

- Daily balancing should be the target model for Europe. In this model balancing energy is bought and sold on an exchange based spot market.
- Any interim model should be designed as such that it stimulates liquidity on the day-ahead and within-day market. A particular interim option to be considered is balancing within multiple hourly blocks, for example within 12 instead of 24 hours.
- Both title transfer and physical inputs and offtakes must be eligible to balance portfolios.
- Frequency and content of information provision by TSOs and DSOs must enable market participants to balance their portfolio. End-of-day balancing requires less frequent information provision than within-day balancing.
- The Framework Guidelines should be sufficiently prescriptive to ensure that harmonization between European member states can take place at key elements such as the balancing period and calculation of imbalance charges.

The following section answers in detail the questions set out in ERGEG's consultation paper.

**Problem identification, scope, definitions, purpose, policy objectives and compliance**

**Question 1:** Do you agree that the problems identified in the problem identification chapter are the main ones? Are there additional problems that should be addressed within the gas balancing pilot framework guideline?

Generally we agree with the problems identified in this section of the document. In particular we see the urgent need to comply with the legal requirement of Art 21 of Regulation 715/2009 to implement a market based balancing, as the Madrid Forum concluded as early as 2006.

**Question 2:** Do you agree with the scope (section 1) and objectives (section 3) of this pilot framework guideline? Are there policy issues that should, but are not currently addressed by the draft document?

We agree with the scope and objectives of the draft Framework Guidelines. Clear and objective principles for the development of a network code on gas balancing are crucial to allow ENTSO G to successfully and efficiently work on said network code within the following 12 months. We therefore would like to stress particularly the need to set out a clear target model in the Framework Guidelines supported by a limited number of again clearly defined interim steps.

**Question 3:** In your view, should the European network code for gas balancing lead to an amendment of national balancing rules? If so, how detailed should the European target model be?

EFET believes in the virtue of a pan-European balancing regime. To implement this will inevitably lead to amendments in national balancing rules. The European NC should be as detailed as possible to avoid different interpretations of its rules in different member states. However, there must be a process to propose modifications to the NC.

**Question 4:** Do you agree with the approach of defining a target model for the network code and allowing interim steps subject to NRA approval?

It is important to define a target model whilst allowing TSOs time to implement it. Therefore it is necessary to propose interim measures to ensure that all Member States have a clear plan as to how to ensure they have the ability to introduce the target model. Gas markets in Europe have developed differently and the NC should take into account the different stages of development. However, it is crucial to minimise regulatory risk by setting out clear rules that, after a certain time, will lead to a pan-European level playing field.

**Question 5:** What timescale is needed to implement the provisions in the target model outlined in Part II after the network code is adopted? Is 12 months (as in section 10) appropriate or should it be shorter or longer?

With regards to the time needed to fully implement a target model EFET does not believe in a one-size-fits-all approach. As long as the target model is clearly defined, TSOs have the correct incentives on them to reach the target model and NRAs have in depth implementation plans including the approval of any necessary deviations on an interim basis, the target model will be able to be implemented in every country in due course. The responsibility should lie with ACER to monitor the progress in individual member states.

**Question 6:** Should the pilot framework guideline be more specific regarding the purpose and policy objectives for network codes (section 3), in particular areas including nomination procedures?

The Framework Guidelines is generally sufficiently specific in section 3. With regard to nomination and renomination procedures/lead time standardisation is clearly needed. Any standardisation should aim at enabling the standard nomination regime to facilitate cross-border trading of flexible gas.

**Question 7:** With reference to section 3 (proposed policy objectives), do you have comments on how Article 21 of the Gas Regulation 715/2009 should be reflected in the gas balancing network code?

Article 21 of the Gas Regulation 715/2009 sets all the principles for a future European balancing regime. Our comments below highlight how it should be reflected in the balancing NC.

### **The role of network users and TSOs**

**Question 8:** Is it necessary to have a harmonised approach to the network user and TSO roles regarding gas balancing?

The implementation of a target model which harmonises the roles of TSOs and network users in every European transmission system is likely to lead to a natural merger of balancing zones wherever and whenever transport capacity between adjacent systems is not constrained. It will hence lead to an integrated European gas market. Regulatory assistance may be required to ensure there is sufficient investment in network infrastructure and in removing any barriers to the development of the most economically efficient balancing zones, including those covering multiple Member States.

**Question 9:** What are your views on the proposals for the target model to be reducing the need for TSOs to undertake balancing activities?

We agree with the principle that TSOs should only have a residual role when it comes to balancing and we think that the proposed target model generally reduces the need for TSOs to undertake balancing actions. However, a residual role does not necessarily imply a reduced need for TSO activity in the balancing market. Balancing regimes are efficiently designed if they (a) allow for a secure and reliable operation of the transmission system and (b)

facilitate a competitive market by reducing barriers to market entry. A minimum of TSO balancing activity is therefore not a goal in itself if this leads to barriers of entry. This is the case in hourly balancing regimes where minimum TSO activity due to the obligation on network users to match inputs and offtakes every hour represents the most serious barrier for new market entrants who generally will not be able to comply with this obligation competitively.

**Question 10:** Is it appropriate for the target model to impose within-day constraints on network users? If so, should such constraints be imposed on all network users or only on certain groups of network users? If within-day constraints should only be imposed on certain groups of network users, which ones are these? How could this be justified?

Technical within-day constraints (such as ramp rates prevailing at CCGT power stations or the obligation to submit load profiles to the TSO) might be necessary for some networks to cope with certain flow patterns at system exit points that are potentially relevant for system stability. They should not be imposed on certain (groups of) network users but on users of certain types of input and offtake points (for example interconnection points), and on certain flow patterns (increase or decrease of flows within certain time periods. In any case within-day constraints shall not impose penalties (or 'adverse' financial incentives) on deviations between inputs and offtakes.

**Question 11:** Is balancing against a pre-determined off-take profile a useful interim step?

Yes, in cases where there is insufficient information on individual portfolio balance status.

**Question 12:** Should TSOs have the option to sell flexibility provided by the gas transmission pipelines system (linepack) subject to the NRAs' approval? If so, should this be mandatory?

Selling linepack as an individual product could create an artificial shortage in markets where there is less flexibility/liquidity available given the sum of the individual needs will be greater than the need of all users in aggregate. Therefore, linepack should remain a system service and be available to all users in the market at an aggregate level.

**Question 13:** Should the target model enable TSOs to provide tolerances to market participants for free or should this be an interim step?

In principle, tolerances should be an interim step: Tolerances reflect the ability of network users to balance their inputs and offtakes. Hence, once network users have access to intraday flexibility, robust and frequently updated information about their portfolio balance and time to act on the intraday market

they won't need tolerances (except a low one-digit number to account for unavoidable deviations).

### **TSO obligations on information provision**

**Question 14:** Are there any additional information requirements that you believe should be included? In particular, should the pilot framework guideline oblige TSOs to provide information beyond the requirements set out in the revised Article 21 and Chapter 3 of Annex 1 to Regulation (EC) No 715/2009 (as recently approved through comitology)? If so, please provide details?

The Framework Guidelines should require that in the case of NDM offtakes load profiled forecast of e.o.d. volumes, temperature adjusted, are provided 4 times/ d (minimum). This would bring network users to the intraday market in case temperature changes unexpectedly and would hence avoid that the TSO is left with a large deficit of gas at the end of the gas day.

The Framework Guidelines should further clarify, that in case of any interim within-day balancing obligations the TSO should be obliged to provide information on the individual network user's portfolio in a frequency that enables network users to balance their portfolio within the specific balancing period. For example, if the balancing period is (or may be) an hour, network users need hourly information on their balancing status, provided with sufficient lead time to take action on the balancing market.

**Question 15:** What are the benefits and disadvantages of TSOs providing network users with system information?

Continuous information on system balance status (system supply-demand balance/ line pack) is crucial to assess intraday prices. In a daily balancing regime it gives network users a signal for the right time to act on the market to balance their expected (e.o.d.) volumes.

**Question 16:** What are the costs of TSOs providing network users with system information? How do these compare against the benefits and/ or disadvantages?

Undoubtedly there are considerable costs involved in providing within-day information on individual portfolio status and TSOs will be able to give an estimation. Ultimately end-consumers will have to bear these costs. On the other hand, greater levels of information will help to create a competitive, integrated European gas market which will lead to competitive pressures on market prices. This benefit is much harder to quantify. However, alternative regimes with cumulative or sub-daily balancing intervals trigger even bigger investments in information systems because the frequency of information provision has to be consistent with the balancing period to enable network users to respond within the tighter time constraints.

## **Balancing periods**

**Question 17:** What are your views on our assessment of the policy options?

The draft Framework Guidelines asks ENTSOG to oblige TSOs to introduce daily balancing. But it allows for within-day constraints in the target model without specifying what these might be. EFET therefore considers that ERGEG has not been clear enough in specifying its target model.. History shows that within-day constraints lead predominantly to hybrid systems with hourly balancing prevailing for large parts of the market. Liquid and competitive markets though will only arise if all sources of flexibility including potential demand side response sources are integrated in a consistent daily balancing regime.

**Question 18:** Are there relevant additional policy options on balancing periods which have not been considered in this section? Should these be considered going forward?

The only relevant additional balancing option that ERGEG has not explicitly included in its target model probably is the idea of “continuous balancing” that will be implemented by the Dutch TSO (GTS) in 2011. This model is clearly a positive step towards market based balancing. Nevertheless, its core concept does not preclude potential hourly settlement and as such demands significant investments in information provision without giving network users and market participants the time to deal with supply-demand imbalances over a sufficient period of time. It should therefore be deemed as an interim step. It should not be included in the target model.

**Question 19:** Is it necessary to harmonise balancing periods? If so, what are the benefits of a regional or pan-European harmonised balancing period? If not, why is it not necessary? Please explain your answer.

See also our response to Q8. Balancing periods and imbalance charges are the most important elements to harmonize. Implementing a target model and harmonising the roles of TSO and network users in every European transmission system is likely to lead to a natural merger of balancing zones wherever and whenever transport capacity between adjacent systems is not constrained. It should hence lead to an integrated European gas market. And it is essential to make this market function properly. Regulatory assistance may then be required in ensuring there is sufficient investment in network infrastructure and in removing any barriers to the development of the most economically efficient balancing zones – including those covering multiple Member States.

**Question 20:** If you agree with a harmonised balancing period, what do you consider is the appropriate length of the balancing period?

The balancing period should be a day.

**Question 21:** Do you agree with the target model? (Please explain your answer).

We agree with the part of the proposed target model that asks for daily balancing. We do not agree with its approach to give NRAs the discretion to introduce non-specified within-day constraints. EFET urges ERGEG to clearly define within the framework guidelines the format of any interim within day restrictions and when they can be used so as to allow ENTSOG to develop consistent and more detailed rules. Although the Framework Guideline might consist of a variety of clearly defined interim measures, including those on the balancing period, the target model should define a pan-European NC on balancing with a daily balancing period.

**Question 22:** What would be the costs of implementing the target model in (and beyond) your Member State or balancing zones(s) (as the case may be)?

It is for the TSO to quantify the costs of implementing daily balancing under the scrutiny of the NRA. EFET considers that the benefits of implementing this will outweigh the costs. From a European perspective it has to be taken into account, that most of the bigger European networks already operate under a daily balancing regime (UK, Italy, France, Germany).

### **TSO buying and selling of flexible gas and balancing services**

**Question 23:** Do you agree with our assessment of the policy options?

On the whole EFET agrees with the assessment of the flexibility policy options... However, in practice the design of a “stand-alone balancing market” can exclude some flexibility providers from participating in the market. For example in the new Dutch system, shippers cannot withdraw an offer 8 hours or less before the potential hour of delivery. This is restrictive for flexibility providers that cannot guarantee 8 hours before delivery that they will be able to offer flexible gas to TSOs. Furthermore, if TSOs go down the road of offering reservation payments to shippers to ensure a certain proportion of capacity is always available on the balancing market, this will also exclude smaller shippers and demand side response from offering genuine help to TSOs. And last, TSOs shall not invest themselves in flexibility assets, but rather provide investment signals to the market.

**Question 24:** Do you agree with the target model? (Please give reasons). If so, what do you consider are the benefits and disadvantages of the target model?

The target model for TSO procurement of balancing gas should be the intraday wholesale market and without prejudice for provisions to cope with emergency situations, the TSO shall be obliged to procure system balancing

energy on a centrally cleared spot market used by network users. Measures should be implemented to incentivise the TSO to minimise the cost of balancing actions. Together with a commercial incentive for network users to adjust their end of day volumes through buy and sell actions on the same market, TSO procurement, will trigger within-day market activity and will thus lead to increased liquidity. Within-day markets in turn not only play a crucial role in the price formation in spot and forward wholesale markets, they also offer a low cost source of flexible gas and hence ease market entry. TSO action on these markets will therefore significantly increase liquidity in within-day and/or day-ahead markets (as witnessed in France and Germany). It is crucial therefore that TSOs start to procure balancing gas to the extent and as soon as possible on this market instead of waiting for liquidity to develop independently.

To enable (some) TSOs to cope with within-day network constraints, this market might need to offer a physical and/or locational product next to the title transfer in order to provide the TSO with the means necessary to procure system energy immediately and/or at a specific input or offtake point within the system. This will also enable TSOs to avoid any potential abuse of the system by network users.

However, these different products can be offered on the same platform, i.e. on the same exchange operated market: A shipper could offer title and physical gas to the market that is technically the same volume. If the TSO hits the physical bid, and a shipper hits the title bid, he can cover the short title via the traded market over the course of the gas day.

**Question 25:** What are the costs of implementing the target model in your Member State?

EFET is a European wide association and as such cannot make statements for costs in a specific member state. Taking into account the overall costs – TSO procurement and individual network user procurement – the implementation of the target model should in the long run save costs in each Member state.

**Question 26:** What interim steps, if any, may be needed in your Member State or balancing zone(s)?

In general, interim steps should always contribute to the development of liquid day-ahead and intraday markets because these markets will eventually become the platforms for selling and buying balancing energy. So, only if the respective National Regulatory Authority, the TSO and stakeholders deem that the traded market is not yet liquid enough to guarantee the procurement of the required system balancing energy, the TSO shall have the option to procure balancing energy through a periodic tender process or through within-day products on a standalone balancing platform separate to the trading market. The term of a tender shall not exceed one year-ahead. Access to this

procurement process shall be subject to non-discriminatory and transparent rules. Option payments may be offered additionally to exercise payments for balancing gas. The TSO shall have the incentive to phase out any procurement separate to the trading market and increase the amount of gas procured on the wholesale market.

**Question 27:** Is it appropriate for balancing platforms to be part of the target model subject to NRA approval, even where markets are sufficiently liquid to enable TSO procurement on wholesale markets?

Balancing markets should not form part of the target model, as it is possible for the TSO to take physical actions on the same platform as market parties. Any separate balancing platform will sterilise flexibility and reduce liquidity in the market.

**Question 28:** Is it appropriate for TSOs to procure balancing services on the wholesale market and/or or is appropriate for these to be procured on the balancing platform? Should TSOs be permitted to reserve long-term contracts for flexible gas and/ or associated capacity for this purpose?

See our response to question no. 24.

**Question 29:** In your view is it possible in your market to reduce TSOs' reliance on long-term products? If so, how may this be best achieved?

See our response to question no. 26.

### **Imbalance Charges**

**Question 30:** Do you agree with our assessment of the policy options?

Again, the assessment of the policy options is generally correct. However, if the TSO has not needed to procure (or sell) gas on the wholesale market or a balancing platform cost reflectivity cannot be the governing principle when calculating balancing charges because there are no balancing costs incurred by the TSO (see p. 49 of the Initial Impact Assessment). Costs for providing line-pack should not be covered by the balancing regime but by general network tariffs. Instead, a market cash-out price ("system average price") when the TSO did not take balance actions in a particular direction should be installed. To incentivise network users to trade out their positions rather than accept this market cash-out price, an uplift of a certain percentage of the system average price should be introduced.

**Question 31:** Do you agree that methods for calculating imbalance charges should be harmonised? If so please explain what the benefits may be. If not, please explain why not.

The reasons given in the draft Framework Guidelines and its accompanying documents are comprehensive: non-harmonised charges or cash-out prices

will inevitably lead to inefficient arbitrage. Whereas arbitrage as such is beneficial in that it leads to a convergence of market prices, it distorts the integration of European gas markets when imbalance charges are not based upon marginal market prices.

**Question 32:** What are your views of the target model? In particular, please provide your views on:

- Whether an imbalance charge should be applied when TSOs do not take balancing actions;

See our response to question no. 30

- What the imbalance charge should be based on, if it is applied when the TSO has not taken a balancing action,

See our response to question no. 30

- Whether imbalance charges should be dual or single priced;

Dual marginal pricing, i.e. System Marginal Price (SMP) Buy for portfolios being short and SMP Sell for portfolios being long at the end of the balancing period, is crucial to incentivise active balancing by network users (see our answer to question the next question). In a single price system imbalance charges do not reflect market prices but apply the same penalty to long and short positions.

In contrast to this understanding, the Initial Impact Assessment paper seems to define “dual pricing” as a system where imbalance charges differentiate between market participants whose imbalance contributes to the overall system imbalance and market participants whose imbalance ‘helps’ the system (see p. 47 of the Initial Impact Assessment). This “helper/causer” system makes sense only if imbalances are cashed out as soon as the TSO takes action on the balancing market. Because only then network users being long when the system is short (and vice versa) “help” the system by reducing the quantity of balancing gas the TSO has to buy (or sell). A consequence of this is that their imbalances have to be set to zero afterwards.

Although helper/causer systems represent a useful interim step for some networks, we do not support such a system as a target system for Europe because it implies potential within-day cash outs and tends to constrain trading to physical trading rather than physical plus virtual trading.

- Whether imbalance charges should be based on the marginal price.

Cash-out prices shall be based on the marginal price of all sell and buy actions of the TSO (system marginal price, SMP) during the balancing period or on the day ahead of it. This will (a) ensure cost reflectivity to the extent possible; it will (b) incentivise network users to balance their inputs and

offtakes without relying on the TSO because they will expect to be able to beat the cash-out price through their own actions on the within-day wholesale market; and it will (c) avoid undue barriers to new market entry.

**Question 33:** What would be the costs and benefits of implementing your preferred options in your Member State?

There are no costs involved in implementing a marginal market price cash-out regime.

**Question 34:** What are your views on the interim steps in the document?

The proposed interim steps are reasonable, however, EFET considers that interim steps need to be specified in more detail and therefore further work is needed to ensure that these interim steps are correct. EFET is currently in discussion with ENTSOG to help derive effective interim steps that will help all markets to implement daily balancing.

#### **Cross-border cooperation**

**Question 35:** Are there any other relevant policy options on cross-border cooperation that should have been included in this section?

The main and most efficient cross-border cooperation is not mentioned explicitly in this section of the document namely network users transporting (flexible) gas from balancing zone A to balancing zone B according to within-day price spreads between A and B.

**Question 36:** Do you agree with our assessment of the policy options in this section?

The assessment of the policy options in this section clearly lacks one fundamental point: Regardless of which specific policy option mentioned there is a need for cross-border transport capacity to facilitate the physical flow of balancing gas between networks. If network user X nets a long position in balancing zone A with a short position in balancing zone B the relevant TSOs will have to transport gas from A to B (unless they can cope with the respective imbalance within their balancing zones); if neighbouring TSOs exchange bids and offers of flexible gas in their markets they again will have to transport the procured gas to their market (the same applies to the use of regional platforms or the use of OBAs for balancing rather than reconciliation purposes). To enable TSO to do this, a certain share of cross border capacity would have to be reserved for this purpose. On the other hand, network users, if able to access the same share of cross-border transport capacity, would be able react to within-day price differences between A and B and transport flexible gas from A to B. This means that the market will deliver the same effect more efficiently and TSO will be able to concentrate on their residual role.

**Question 37:** Are Operational Balancing Accounts (OBAs) useful to deal with steering differences? Should the network code make it mandatory on TSOs to put in place OBAs?

As correctly described in the document OBAs are mainly used to allow TSOs to manage the fluctuations in cross-border gas flows, which may occur as a result of differences in gas qualities or steering differences. For the reasons described above this purpose should not be extended to any form of TSO-TSO balancing.